RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

Since 1958 •

Post Office Box 1759, La Jolla, California 92038

26 Letters Per Year • $250 annually

Aug. 18, 1993 **LETTER 1128**

MISTAKE?: Back in 1946 I took a course at New York University taught by the great teacher and philosopher, Sidney Hook. The course was entitled, "The Philosophy of Democracy." Professor Hook made one statement that I'll never forget. He said that the essence of Democracy was that *"it allowed the people the right to make their own mistakes."*

Did the American people make a mistake in electing Clinton? Did they make a mistake in electing a Congress that endorsed the Clinton program? I think they did, but now the die is cast. Now we'll see whether higher taxes and increased spending will produce a more prosperous nation.

It's ironic that Europe, which has been steeped in the philosophy of welfare, is now in the throes of a vicious recession. But significantly, almost every European nation is now moving away from the welfare syndrome. At the same time, the US is embracing greater welfare under the auspice of a President who is enthralled by the philosophy of big government and higher taxes on "the rich."

THE MARKET: Despite a succession of record highs in the Dow (unconfirmed by the Transports), many of the broader indices have failed to confirm.

The NYSE Composite is a very broad index reflecting the total market value of ALL the stocks on the NYSE (the Index is weighted for total number of shares outstanding). The chart of the NYSE Composite for the year 1993 looks like one long thin horizontal line. There's been little movement either up or down. The HIGH for the NYSE Index was set back on March 10 at **251.36.** Interestingly -- there's been one heck of a lot of volume on the NYSE. A lot of stocks have been changing hands.

The S&P 500 is also a broad index reflecting about 75% of the value of all the stocks on the NYSE. The high for this index was also set back on March 10 at a value of **456.33.**

So you have to ask yourself, who's been doing all the selling and who's been swapping all that cash for stocks? And the answer, of course, is that we don't know, and we won't know until the stock market either breaks out decisively on the upside or does a swan-dive on the downside.

As a rule, however, this kind of churning (i.e., high volume with the market making little progress) is a negative. As a rule, it implies stocks moving from strong hands to weak hands. As a rule, a churning market is a topping market, so it will be most interesting to see if "as a rule" works here in 1993.

Predictions and scenarios can be fascinating, and I've heard a hundred arguments regarding why this almost ridiculously expensive stock market is living on borrowed time. Opinions are one thing, but in this business we also have to deal with a little item which we call REALITY. That's where my Primary Trend Index comes in.

My Primary Trend Index (see page 2 chart) continues to record new highs, and the advance-decline ratio also continues to advance to new highs. Since October, the Advance-Decline ratio has never declined as much as one whole point, and this means that the Buying Stampede on the NYSE remains in force. For new

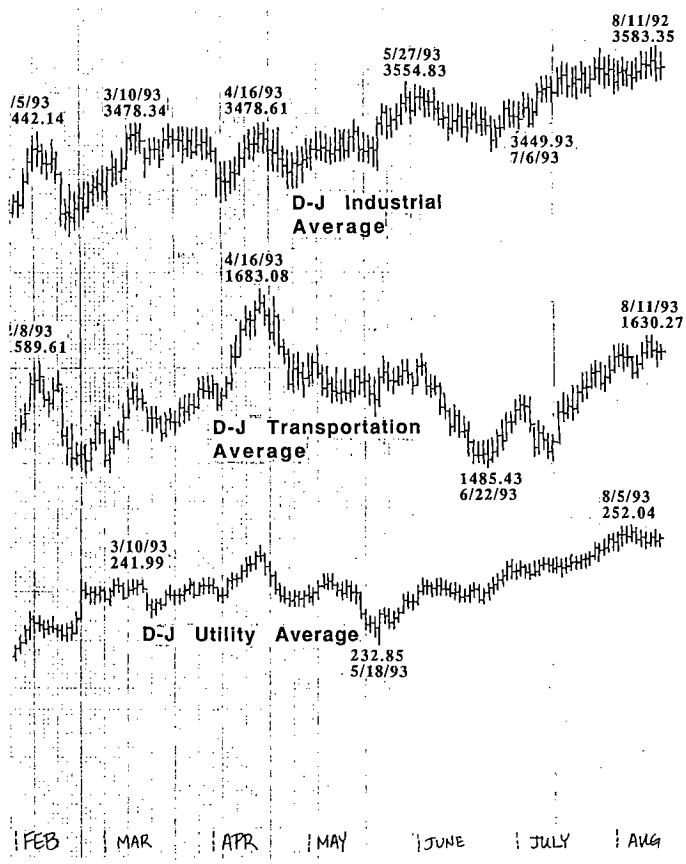
Aug. 6 DJIA 3560.43; PTI 3891; A-D Ratio -3.82
Aug. 13 DJIA 3569.65; PTI 3903; A-D Ratio -3.60
Dow Yield: 2.86%; Dow Price/Earnings: 43.1
Dow 200-day MA: 3402; Dow 30-day MA: 3538
Dow Times Book Value: 2.74; PTI 89-day MA: 3839
Percentage of Undervalued Blue-chips: 7%
Low Risk Buy Index: +61

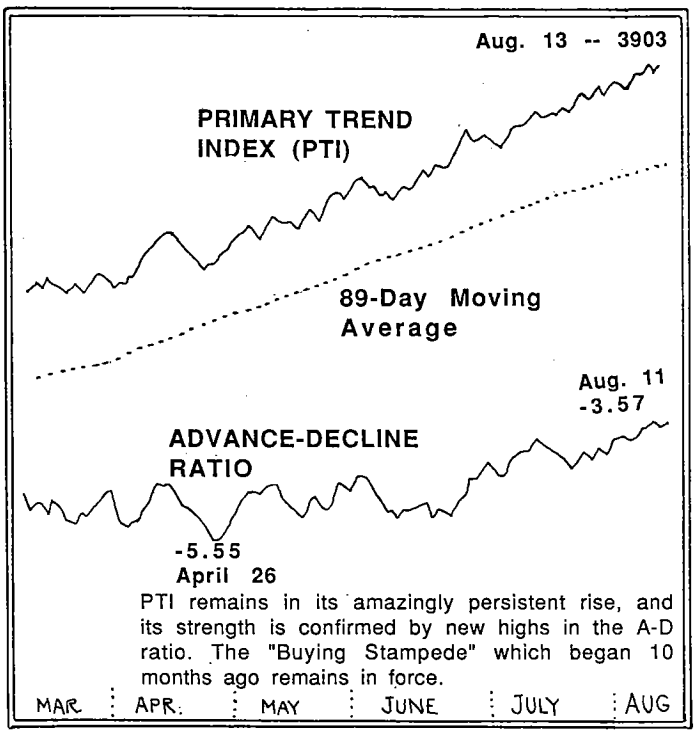
subscribers, I should repeat that a Buying Stampede is any rise of five points or more in the A-D ratio without an intervening correction of as much as one point.

THE PTI: The most remarkable (and fascinating) property of the stock market is its ability to look ahead, to discount the future. In market analysis there are two classes of people: (1) those who fully believe in the market's discounting abilities, and therefore, those who believe that the stock market is its own best forecaster, and (2) those who believe that through their own study of earnings, economics, politics and business conditions, they can predict the future path of the stock market.

Place me in the category of those who believe that the market is its own best forecaster. By the same reasoning, I am also of the opinion that economic forecasts, professional appraisals, earnings projections, etc., are largely useless in predicting the direction of the market -- and, in fact, such studies are more apt than not to be deceptive.

Many, many years ago I concluded (via my Dow Theory studies) that the market "knows" more than any man or group of men, and that the market itself is its own best forecaster. However, one fact has to be faced -- a correct analysis of stock market trends is not a





science, it's not even an inexact science. No, it's an art and a very difficult art at that. Or as my old friend, John Magee,used to say as he thumbed through hundred of charts, "It's not the charts that are wrong, it's the chart readers."

I first started studying the stock market in 1945. At that time (the War was over and I had just been released from the Army Air Force) I read about Henry Kaiser, the famed industrialist who had been a miracle producer during the War. Kaiser was about to manufacture the Kaiser-Fraser car -- a new car that he boasted would give General Motors all the competition it could handle (I read about this in *Time* magazine).

The concept of a brand new American car sounded marvelous and thoroughly convinced me. I promptly bought 100 shares of Kaiser-Fraser stock at 20. A year later, during late-1946, Kaiser-Fraser stock was at 6. A few years later the company was belly-up. I accepted the whole affair as a lesson. And that started me on a quest. I wanted to discover what made the stock market tick. I also wanted to learn why a highly-touted stock like Kaiser-Fraser could collapse, collapse in the face of all those glowing forecasts.

I spent hours, days, weeks, in the huge economics section of the New York Public Library. I searched through book after stock market book in an effort to discover how the market functioned. Finally, miraculously, I came across the writings of Robert Rhea. It was actually a hand-bound volume of Rhea's "Dow Theory Comment" letters written between 1932 and 1939. That volume had an effect on me comparable to a light bulb turning on in a dark room. I had found a book that made sense. I became obsessed with Rhea's Dow Theory theories, his writings, his thoughts, his market analysis. I think I literally memorized seven years of Robert Rhea's reports. In effect, I had a mentor that I had never met or even seen.

Time passed. I became an ardent Dow Theorist. I ate, slept, dreamed Dow Theory. I studied the market until my eyes turned red, until I was half-blind. In mid-1958, amid a severe economic recession, I turned super-bullish on the stock market. I was convinced that a massive advance was in the cards.

On the basis of my bullishness, I started *Dow Theory Letters*. In December, 1958, I wrote an extremely bullish article for *Barron's*. In the article I predicted that a major stock market advance was at hand. The article had an electric effect. Hundreds of Robert Rhea's former subscribers (Rhea had died in 1939) wrote in to subscribe to my Letters, as did many *Barron's* readers. In the meantime, the market embarked on a breath-taking rise. *Barron's* asked for more articles. Subscriptions continued to pour in. I was amazed. And I was in business.

Those were the days when technical analysis of stocks and the stock market was considered an occult science. Charts were seldom seen or used. Bankers or investment advisors who subscribed to *Dow Theory Letters* asked that the *Letters* be sent to their homes. They didn't want their employers to know that they had anything to do with technical analysis.

But gradually, as other analysts entered the business, technical analysis became increasingly accepted. My Dow Theory articles in *Barron's* were drawing a wide following. My business was flourishing. I had put every cent I had into the stock market, and I made a lot of money in the great bull market advance of 1957-60.

Around the end of the 1960s I found something new to worry about. I was worrying that too many people were accepting technical analysis. I was afraid that "too many cooks were spoiling the broth." For that reason I felt that I wanted to develop my own proprietary indicator.

Ideally, I wanted an indicator that would be almost guaranteed to keep me on the right side of the market. The indicator might be early, it might be coincident or it might lead -- but it could not (due to its construction) move against the main trend of the market. I would call the indicator my Primary Trend Index (PTI).

I knew one thing -- the PTI would have to be based on "action of the market" indicators. I had had a good deal of experience with subjective indicators, odd lots, short interest, Confidence Index, insider activity, floor trader shorts, etc., and I noted that all too often these indicators would fail -- usually just when you needed them most. So what I was looking for was a collection of indicators that had strictly to do with market action. Market action indicators are the most reliable -- they do not allow for interpretation. When bonds are up, well they are up. What's to interpret? I spent two years in trial and error studies of various combinations of indicators, averages, indices.

Finally, I settled on eight indicators which I trusted the most. I combined then into what I called my Primary Trend Index (PTI). I began tracking the PTI on a daily basis in early 1971. I have kept daily tabulations of the PTI ever since.

Over the years I learned that the most difficult part of using the PTI was believing in what it was saying. Many times the PTI would define trends that were totally opposite to what I thought "should be happening." In almost every case, the PTI was correct, and I was wrong.

However, sadly, the PTI was not the perfect indicator. You see, the perfect indicator would not only tell you when the trend was changing, it would tell you how long the new trend would last and how far the new trend would carry. The PTI would perform only one of these functions. It would tell me when the trend was changing. But one can't be greedy -- to know WHEN the trend was changing was gift enough.

Through trial and error I learned to use the PTI in relation to its own 89-day exponential moving average. When the PTI was above its moving average and rising, the trend of the market was up. When the PTI was below its moving average and falling, the trend was down. It was as simple as that. New subscribers asked me how to use the PTI. I told them, "It's easy -- all you have to know is UP from DOWN."

I'm not going to go into the whole 23-year history of the PTI. Suffice it to say that it has kept me out of trouble many times (veteran subscribers can attest to that). When it is a contest between what Richard Russell thinks and what the PTI is saying, I've learned to bet on the PTI.

Recent history: After spending all of the year 1990 below its moving average (in its bearish mode), the PTI rose above its moving average on January 31, 1991 (the Dow was at 2650 at the time). The PTI has remained in its bullish mode ever since. On a number of occasions the PTI has retreated and touched its moving average, but it has never broken decisively below it. Therefore, I have kept the bull in the box ever since early-1991.

Back on January 31, 1991, when the PTI finally surged above its 89-day moving average, neither I nor anyone I knew that that bullish signal would be followed by a rise in the Dow to over 3500. As I said, the PTI only tells us direction, not the extent or duration of a move. Nor does it tell us whether the stock market is undervalued or overvalued.

But I'm thankful for small favors. And the PTI, in my mind, is a small favor. I have subscribers who are interested mainly in the PTI. I don't know if they even read the rest of the Letters. I have other subscribers who read the Notes & Quotes and pay scarce attention to the PTI. Personally, I have learned always to be aware of what the PTI is saying.

This bull market will last as long as the PTI traces out a bullish path. When the PTI heads decisively down, you can be certain that the bull market is over.

True, it's late in the game. The great, the fabulous bull market that began in December, 1974, is now 19 years old. That makes it the greatest and the oldest bull market in history. One sign of the bull market's aging is the collapse of many top-grade stocks. Another sign is that only 7% of all the blue-chip stocks are now undervalued. But bolstered by extremely low interest rates and swamping liquidity (both provided by the Fed), the bull trend pushes on.

I suggest again that subscribers take heed of the trend of the PTI. When it turns down, when it breaks below its 89-day moving average, when it heads down from there, I would guess that we will experience a bear market that will be a hell-raiser. It should be a bear market that will correct a 19-year bull market that has raised the Dow from 577 in 1974 to the 3500-3600 range, a rise of 3000 points.

In my studies, I have seen that almost every bear market corrected at least 50% of the gains of the previous bull market. If this rough formula were to hold true again, the coming bear market will take the Dow down to at least the 2000 level, and probably below that.

Why will the bear market occur? What will cause it? I don't know -- but it will surely be a great many items, some of which are known today, and many of which are not known.

The saddest comment about a bull market is that just as night follows day, every bull market in history is followed by a bear market. The happiest comment about a bear market is that just as the ocean's tide runs out but then comes back in, every bear market in history is followed by a bull market.

It's a story as old as the markets. Incredibly, when a bull market is in its prime nobody ever believes a bear market will materialize. And when a bear market is doing its worst, nobody can ever envision that a bull market is just around the corner.

INVESTMENT POSITION: The PTI tells you the underlying trend of the market, and the A-D ratio tells you what's happening to the majority of stocks. Neither of these will tell you what stocks to buy or how long to hold your favorite stocks. Therein lies a problem. This market has become viciously selective, so much so that many premier investors and fund managers have now moved heavily into foreign stocks, claiming that there are much better values overseas.

Mutual funds put big bets overseas

By John Waggoner
USA TODAY

If you're a stock mutual fund investor, don't rush to boost your overseas stock holdings. Your fund manager may have done that for you already.

the first six months of 1993, vs. $3 billion the same period last year. The lure: Falling interest rates in Europe could boost European stocks.

Fund managers agree. Eric Ryback, the Lindner fund's skipper, has been snapping up

Most of the investors I talk to (and I talk to a lot of them) tell me that their losers about offset their gainers, and that this situation is not only frustrating them, but it's making them just a mite nervous. As for me, I sleep about five hours a night, but that five hours is important to me. Accordingly, I'm very light on stocks (except the golds) at this point.

An old stock market adage tells us that "the single most bullish thing the market can do is to go up." Obviously, it's hard to argue with that logic, but at this point I look at it slightly differently; I tend to feel that every 10 points higher in the Dow is 10 points nearer the ultimate top.

How about the gold shares here? For some reason, I'm reminded of an experience I went through many, many years ago. A brilliant old Dow Theorist (he's dead now) named Justin Barbour came up from Texas to visit me -- this was around the mid-1960s. Barbour told me that he had spent a year researching one stock, Burroughs, and he convinced me that it was a great buy. On his advice I bought 500 shares of BGH at 20. That stock backed and filled between 19 and 24, rallied and corrected until I was worn out watching the damn thing. Finally, a miracle, Burroughs broke out and rallied to 40. I had doubled my money -- so very happily I sold the stocks. It had been a long ordeal. A month after I sold it, BGH started up again. Three years later it was at 240. I had sweated through the rough part of the long, arduous basing action, but I had missed the BIG move.

Subscribers are asking me about **bonds.** Short-term, I dunno, but longer term I'm bearish. Charles Minter of *Comstock Partners* thinks longer term rates will move higher, and I concur. His prediction centers around the government's growing debt, which will push over $5 trillion in a few years. Says Minter, "Like any company that keeps issuing more paper, at some point people have to question the ability to pay back." It happened in oil-patch and farm-belt debt in the early '80s. Then came the bust in Third World debt. Junk bonds followed. "We believe the next entity to be hit will be the US government. There's never been a debt of this magnitude that's ever been paid off" with a stable currency.

Remember the Russell comment -- if I had to stake my life on a single prediction about any event to occur say 10 years from now this would be my prediction -- the purchasing power of the US dollar will be down, down, DOWN. As a corollary -- the greater the debt, the greater the ultimate fall of the currency, and the greater the rise in gold in terms of that currency.

Note: a few Letters back I wrote that my "Low risk buy index" gave a buy on the money-center banks. Nationsbank has been one of my favorites, the main reason being that NB recently bought one of the largest derivative businesses (options and futures). NB has just moved up over five points. I like it. Profits coming up should be impressive.

NOTES & QUOTES: What ever became of the much-touted "Peace Dividend"? Well, we got it, the Peace Dividend turned out to be UNEMPLOYMENT. Since the end of the Cold War, one million defense workers in the US have lost their jobs. Real defense spending in the US is slated to drop 25% over the next four years. Since 1986 IBM has laid off 150,000 workers with another 35,000 layoffs coming up. Lockheed is planning on laying off 24% of its 19,000 work force. The pink slips just keep coming out, making almost every American worker nervous and less prone

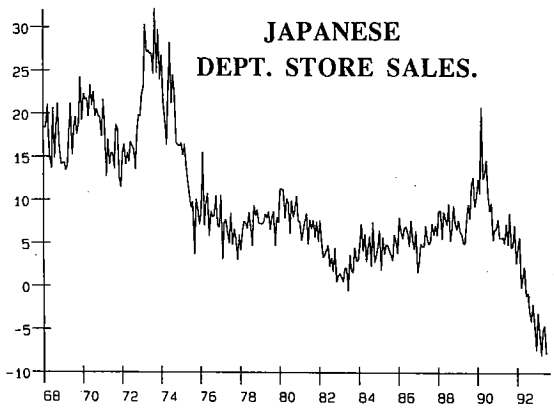
to spend (Merrill Lynch projects that the US defense workers will lose another million jobs by 1996).

* *

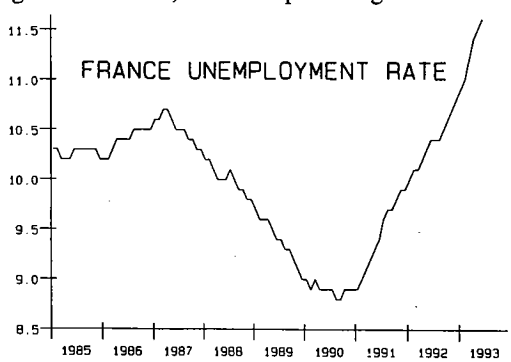
Japan is facing its roughest financial times since World War II. Part of the problem is the collapse of land values and real estate prices. In Tokyo many office buildings are down 40% or more in price and vacancies are now plentiful. But Japan now has a big competitor -- it's China. Interesting insight: the Japanese Cotton Spinners' Association is claiming that Chinese manufacturers are dumping fabrics in Japan at 30% to 40% below the price of the domestic (Japanese) product. This presents a problem for Japan, since China also offers a huge market for Japanese exporters. The rising power of China is also stirring up debates in Japan as to whether Chinese political and military influence in Asia will be overwhelming.

* *

This chart (courtesy of Ed Hyman and *ISI*) shows what's been happening to Japanese department store sales. With their imports sliding due to poor business, Japanese exports remain high. This keeps their trade balance figures high (Japan's trade balance was up 19.8% in the first half) and this is a major plus for the yen. But the minus is the rotten Japanese economy. Furthermore, the yen is super-expensive on a purchasing power parity basis. Russell opinion -- the yen may be topping out vs. the dollar.



A second Hyman chart shows the exploding French unemployment rate. Most of Europe is in recession, and this means governments opting for lower interest rates, competitive devaluations and rising money supplies. All of this is what's pushing stock markets around the world higher. Of course, it's also a plus for gold.

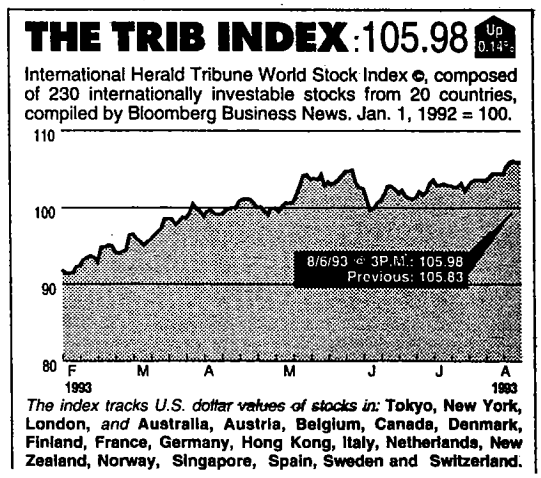


* *

One major problem for Europe is the very high cost of welfare. The costs are sending European deficits through the roof. But Europe's recession and soaring unemployment is having its effect, and the effect will have to be a cut in benefits (and the same syndrome will apply to the US). Following is the story on wages and benefit costs in various countries. Germany is the most expensive, where workers get $26.90 per hour. Sweden -- $24.65. Japan -- $19.23. Italy -- $19. France -- $17.79. US -- $15.89. Spain -- $14.70. Britain -- $14.70. But get this: Taiwan -- $5.19., S. Korea -- $4.93. You can see why Asia is tough competition.

* *

This chart from the *International Herald Tribune* shows the Trib Index of 230 major international stocks at new highs. Obviously, the world's stock markets love declining interest rates and expanding money supplies.


THE TRIB INDEX: 105.98
Up 0.14%
International Herald Tribune World Stock Index ©, composed of 230 internationally investable stocks from 20 countries, compiled by Bloomberg Business News. Jan. 1, 1992 = 100.
110
100
90
80
8/6/93 @ 3P.M.: 105.98
Previous: 105.83
F M A M J J A
1993 1993
The index tracks U.S. dollar values of stocks in: Tokyo, New York, London, and Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Italy, Netherlands, New Zealand, Norway, Singapore, Spain, Sweden and Switzerland.

* *

Lexus must be pretty sure of its cars. I just got an offer in the mail (courtesy Lexus) to test drive at no charge a Lexus, a Mercedes 300-E, an Acura Legend LS, an Infiniti J30 and a BMW 540I. Says Lexus, our car "rides smoother and corners better than" all the other cars "costing thousands more." On top of all that, beckons Lexus, "Refreshments will be served." And wait, if you can't make it to the test area, Lexus will bring their car to your home! Talk about tough competition.

* *

Martin Gross spends his time uncovering government waste and stupidities. Says Gross, "The US Government is a giant slush fund, many politicians are pathological liars, and what they are doing is nothing less than evil." Among the idiocies that Gross has uncovered: $57,000 spent for gold-embossed playing cards for Air Force One; $150,000 for a study of the Hatfield-McCoy feud; $144,000 to see if pigeons follow human economic laws; $2 billion on new office furniture for Congress and government employees; $1 billion worth of helium gas reserves, stored underground at a cost of $100 million a year; $3 billion for 1,300 private government planes, 200 of which could not be accounted for. The biggest shock: $200 billion or 15% of the federal budget for "Other Expenses" and on this "the government refused to give any breakdown whatsoever." Russell comment: Think about this as you pay your new increased taxes, courtesy of Mr. Clinton. But seriously, what Gross' studies show is that our Government is stultified, frozen, unable to respond to reality. It isn't "our Government" any longer, it's "their Government" or somebody else's government. It's a monster having taken on an insane life of its own.

* *

Business Week calls it "one of Washington's dirtiest secrets." It's "the unspoken budget buster." They're referring to one trillion dollars in unfunded employee's future pension benefits. The government hasn't been accounting for retirement benefits for millions of its workers. Two of the largest so-called trust funds set up to cover 7 million civil-service and military employees are now underfunded by over one trillion dollars. This is a guaranteed future shock. By the year 2010 the annual funds needed to cover these benefit payments will triple from current levels to $160 billion.

* *

Clinton talks about the greedy '80s. How about this for greed -- from 1980 to 1992 government revenues rose by 95%, government spending exploded up 137% and the deficit sky-rocketed 366%. The problem is clearly government spending. The single worst approach to the problem -- raising taxes.

* *

Speaking of taxes, here a piece from a business owner that appeared in *Financial World* (August): With the new Clinton system, "Our companies will pay 40% federal and state income tax. That leaves 60 cents on each dollar earned. In many states I'd pay 50% on all dividends from that remaining 60 cents. If my company fails, I lose 100% on my investment. If it succeeds, I lose 70% of my gains. Who in his right mind would invest with odds like that? No casino is worse. Yes, I can try sub S bases with their

myriad restrictions or wait years for capital gains in order to keep 41 cents rather than 30 cents -- over every dollar earned. Still, all the downside is mine, most of the upside is the government's."

* *

The *WSJ* says this about the new tax rates: "Social Security recipients and upper-income Americans may be startled to learn that the actual top rates they would pay are even higher than the rates they have been reading about. The new top stated marginal rate would jump to 39.6% this year from 31% previously. But the actual top rate would be much higher for many people. The accounting firm of Deloitte and Touche shows that some self-employed, upper-income taxpayers with large families would wind up paying an effective marginal rate of over 44%."

* *

Hollywood is hysterical about the "Heidi Chronicles." Heidi Fleiss is a young madam who, it seems, has an explosive and very revealing black book of Hollywood names. Sydney Biddle Barrows, the "Mayflower Madam" of a few years ago, offers Heidi (who is under indictment) some advice: "Get the best lawyer money can buy . . . Beware the IRS. There's a very, very real chance the IRS will come after you. The chances of going to jail for being a madam are not real high, but the IRS will absolutely crucify you."

* *

A few years ago South Beach in Miami was bargain basement for real estate. No more -- it's boomtime now. Land costs along the beach are running about $200 a foot. According to the latest *Playboy,* South Beach has become the "girl-watching capital of the universe." Funny, I could have sworn the La Jolla beaches were.

* *

Real estate in New York still has its problems. Remember Ian Schrager, the operator who bought old, run-down hotels in New York and turned them into upscale palaces? He's now said to be losing money on two of his hotels, the Royalton and the Paramount, and a third, Morgan's, was recently foreclosed by the Bank of Tokyo.

* *

In an op-ed piece in the Aug. 5 *WSJ,* a Washington DC lawyer, Stephen Glazier, states that Clinton's retroactive taxes are unconstitutional. He sites Article 1, Section 9, Clause 3 of the Constitution which says that "no . . . ex post facto law shall be passed." Thus, the retroactive part of the Clinton tax abomination should make a good case for the Supreme Court. Questioned about it on an ABC broadcast, VP Al Gore defended the tax increase saying that "all the hoopla and waving of arms about retroactivity is all on behalf of the wealthiest 1% of people in this country." That's right Al, as long as only a small minority of "the rich" are affected -- who cares about fairness or Constitutionality. Talk about fomenting class warfare.

* *

Ah, the Postal Service again. For the current fiscal year the PO announces a $500 million deficit, and they project a $1.5 billion deficit for 1994 and another boost in postal rates for 1995. Mercifully, in due time, FAX will totally take over and the US Postal Service will be just another chapter in American history. (Please forgive me, government workers, but I when I started *Dow Theory Letters* a first class stamp and overnight delivery was three cents. An increase of 866% since then is a bit much to take.) One other thought -- they can privatize the PO and make it work.

* *

The Post Office loves to sell stamps. The stamps are a big money maker. Of course, almost all the modern stamps are worthless or to put it more honestly, they're worth about their face value. But the Smithsonian is opening a National Postal Museum in the old City Post Office Building in Washington. The museum will contain 12 million stamps and will be the third most valuable collection in the Smithsonian after coins and gems. Stamps had their heyday back in the late seventies, but the market caved in during the '80s and has never come back.

* *

It's strange, the way the media latches on to one theme, then after a few months the theme is dropped, and another one is featured. One place that has received almost no publicity is Sudan, home of "The Silent Killing Fields." In Sudan more people have died than Bosnia and Somalia combined, and the Bashir government in Sudan continues to commit genocide. Listen to this report from the *Agency for International Development*: "The Nuer people drag the bodies of those who starve to death out beyond the village for the vultures to pick over and the hyenas to drag away. In the therapeutic feeding center, ward after ward of near-death children -- literally black skins over white skeletons, lay motionless. One of the CDC team members reportedly feared that the trauma of weighing and measuring the children would kill some of them. The only source of water is a contaminated pool that is shared by the people and the few remaining cattle. Malaria, scabies and guinea worms are widespread. Almost two million people have died already."

* *

INC magazine (August) comes up with the ideal corporation for the '90s -- it's the "virtual corporation." What's that? It's a company with no employees, little overhead, everything contracted out to other suppliers. Actually, the traditional BIG American corporation is far from ideal today. With huge entitlements and expenses connected with today's employees, every US company is trying to "cut to the bone." The Clinton program will intensify the drive towards more computers and fewer workers.

GOLD: It's rodeo time for the precious metals. Meaning what? Well, if you've ever talked to a rodeo cowboy (and there's a slew of 'em in San Diego), they'll tell you that the toughest and most dangerous rodeo event is bull-riding. And if you've ever been to a rodeo, you know that the bull will do anything he can to get that rider off his back. He'll snort, he'll whip around, he'll leap five feet off the ground while twisting wildly, and if he succeeds in getting the rider off his back, then watch out -- he'll try to gore him.

It works the same way in the early part of any bull market, and gold's no exception. Gold turned up from its 326 low in February and pushed up to an intra-day high of 414. The XAU gold/silver index (see last Letter) advanced from the December low of 65 to 129 in August. In the face of that kind of action, even the gold-haters began to back off. Gold options went bonkers on the upside, and it was widely announced by the gold crowd that a new gold bull market had been born.

I've warned in Letter after Letter that the early action in a bull market is always erratic, often violent, and subject to persistent rallies and scary corrections (traders call these periodic corrections "gut-checks"). This gold bull market is no exception.

On August 5, we saw a $22 down-day in gold, and the newspapers loved it. In fact, the media was hysterical. *The NY Times* gloated about "Gold's Long, Seductive Climb" (see montage). Seductive?

The New York Times

Gold's Long, Seductive Climb Ends in a Flash

Gold's Plunge Accelerates In Sharp One-Day Sell-Off

COMMODITIES

By Jeffrey Taylor And Neil Behrmann

Gold Prices Plunge

Daily prices, December contract, in dollars per troy ounce

$415 405 395

Gold Prices Take a Big Tumble

■ **Markets:** The $22 drop caught some by surprise. Big and small investors were left wondering where prices are headed next.

By David W. Myers

Times Staff Writer

$410 400 390 380 370 360 350

C'mon, you mean all of us who bought gold earlier and now show profits were seduced? *Reuters* headlined it, "Gold Prices Collapse." *Associated Press* screamed about a "chaotic worldwide trading panic" as "frantic traders dumped their gold holdings." Another *Reuters* wire warned, "Gold's Allure Tarnished."

Why the haste to bury gold? Why the fury to denounce the metal? It's obvious -- the media has fully accepted the politicians' fear and loathing of the yellow metal. Gold is real money, money that is outside the system, money that cannot be devalued or destroyed by the politicians. For all these reasons, gold is a threat to the manipulators and inflationists. And it's the nemesis of the Fed.

Actually, the sudden breakdown of the European Rate Mechanism (ERM) sent gold higher than it "should have gone" this soon in the game, and I felt that what would have been a milder correction was rendered severe by that final news-inspired surge in gold to the 410 (spot) area.

What now? When the bull-rider is knocked to the ground, he hurts, he gets up slowly, he rubs his joints, checks for broken bones. Then he walks out of the arena, finds a seat, and catches his breath. If the rider bounced down very hard, it may take him a week or even a few months to recover. Why should gold, which has been battered down hard, do any less?

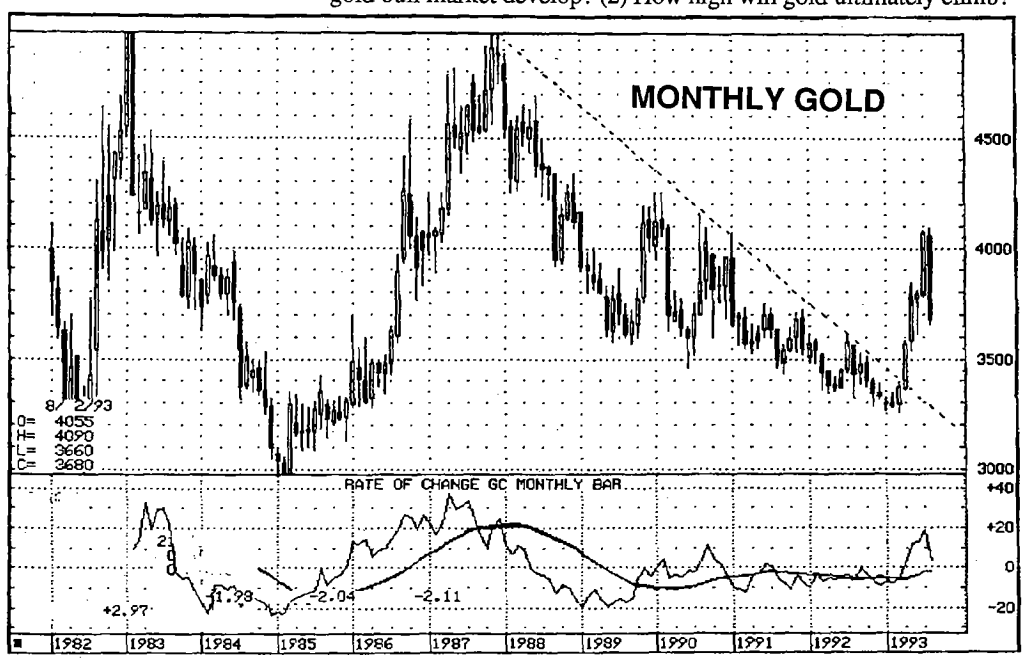
After August 5 many people called me to ask, "Do you still think it's a bull market?" I told them the primary trend doesn't reverse on news or on a one-day smash. The primary trend of any item ends in only one way -- exhaustion, and gold is far from exhausted on the upside. In fact, the August 5 whack simply took additional gold out of weaker hands and placed it in stronger hands.

NEXT MAILING: Sept. 1, 1993

What's next for gold? Do you want honesty, or will you settle for baloney? Honesty? OK -- there's absolutely no way of knowing. I do think it's a bull market, and nobody on earth knows how a bull market (particularly in its early phases) will work out.

For perspective, I'm including this monthly candle-stick chart of gold. The white bars are months of advance, the black bar signify months when gold declined.

A few situations are clear on this chart. The first is that gold bottomed in 1993 at 326, considerably higher that the 1985 bottom of 284. This is a long-term plus. The second item is that on its recent upward surge, gold broke out above a six-year declining trendline.



The next item is that as seen on the white bars, gold rose for five consecutive months. It hasn't done that since its 1980 bull market peak.

When any item advances for five months in a row, it's going to arouse a lot of enthusiasm, usually too much enthusiasm. After excessive enthusiasm (yes, even in a bull market) comes a correction and usually a flip-flop back to pessimism. And that's where we are now.

Note on the chart that gold has now erased the gains of July and June and part of April. How low could this correction go? My guess -- 350 to 360, but it could also hold higher levels, there's simply no way of telling. The usual (and most intelligent) answer to the question is that the correction will go as low as needed to bring in the big ("informed") buyers once again.

I'll remind subscribers that when you buy gold or gold shares or gold options you're going against the system. The system amounts to this -- the government consistently spends more than it takes in. The government makes up the difference by issuing paper credits. The credits build and build, until now they are well above $4 trillion. Furthermore, the credits (debts) will build as far as the eye can see. Get this straight -- the Clinton program doesn't even pretend to cut back on the amount of credits, it simply "intends" to cut back on the RATE OF INCREASE.

As I see it, we are now at the point of no return. The US economy is now running at low speed, and this with the help of $1 billion a day in additional deficits. What happens if the government tries to actually cut back on the total amount of debt? The answer -- depression, which is politically unacceptable. The ultimate answer to the whole problem -- the government will pay off as it always has, but in depreciated paper dollars.

Gold, real money? The last thing the government wants to see is gold in a bull market. Why? Because rising gold tells every American that he's being swindled in that year after year his dollars and his savings are WORTH LESS.

That, in a nutshell, is the great problem facing the Fed, namely, how to print money in massive quantities while at the same time keeping the inflationary implications away from the public. But rising gold lets the cat out of the bag. Rising gold reveals to the voters the dreaded fact that the dollar is losing purchasing power year after year.

All of which tells us that gold is a LONG-TERM holding. If, on a long-term basis, the purchasing power of the dollar is heading down (which it is), then gold, in terms of dollars, will cost more. Which leaves us with only two questions: (1) How rapidly will the gold bull market develop? (2) How high will gold ultimately climb?

LATE NOTES: I've been talking about the extreme low volatility of the market. Jim Stack notes that the Dow has been trapped within a 13% range for the last 19 months. This has never happened before. In the past, tight ranges of this kind have generally not had bullish resolutions.

Aug. 16 -- the dollar suddenly turns very weak. Are the currency markets sensing the US sinking back into recession? Could be. The St. Louis Fed's chart of Commercial and Industrial Loans turns down sharply. Consumer confidence continues to slide. The Clinton tax-and-spend program may be all that's needed to push the US back into recession. Stagnation and inflation could well be the trend of the future.

Please DO NOT MISS the excellent editorial (page 10) in the Aug. 16 Barron's.